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Alternative mode to Islamic home financing

By Dzuljastri Abdul Razak

A Canadian-based cooperative is looking at forging a working relationship with a Malaysian cooperative to develop the musharakah mutanaqisah (diminishing partnership) mode for home financing. The initiative, discussed at a recent conference organised by the IIUM Institute of Islamic Banking and Finance (IIBF), could possibly bring forward another venue for Islamic finance financing via the cooperative movement. Dzuljastri Abdul Razak, a senior academic fellow at International Islamic University Malaysia's (IIUM) Kulliyah of Economics and Management Sciences discusses the issue.

In October 2008, a seminar was organised jointly between [IIUM Institute of Islamic Banking and Finance](#) (IIBF), [Angkatan Koperasi Kebangsaan Malaysia Bhd](#) (ANGKASA) and [Ansar Co-Operative Corporation](#), Toronto, Canada, to study an alternative mode of Islamic home financing known as **Musharakah Mutanaqisah or Diminishing Partnership** from the cooperative perspective. In this concept, a member and cooperative are partners and purchased the house jointly. As joint owners, they share profit between them based on rental rates, which can be changed during the period of financing.

The member purchases the cooperative's share to own equity in the house. The international Shariah scholars are consensus on the permissibility of the Diminishing Partnership compared to the practice of Bai Bithaman Ajil (BBA), which is shun by the Middle Eastern Shariah scholars as not meeting the true spirit of Islam and promoting the well being of the society. The current mode of home financing provided by financial institutions is based on debt financing using interest rate as its pricing mechanism. Even in the existing Islamic banking system the BBA or deferred installment sales home financing facility is based on debt although the bank charges a profit rate.

However, the current benchmark used is still based on interest rate. There are criticisms on the implementation of BBA home financing due to its high pricing, early settlement or when the customers defaulted. This is because the bank capitalises profit upfront in its selling price for the entire tenure, thus making its operations to be very rigid. Furthermore banks will only rebate its profit at its own discretion. Nonetheless, in conventional financing, banks do not capitalised interest rate upfront, which makes it cheaper than BBA home financing during period of low interest. Example of the operations of Diminishing Partnership in home financing for cooperatives.

Step 1: Member signs Sales and Purchase agreement with the developer to purchase the house. As an example, say the cost is RM200,000. Member pays the initial deposit (e.g. 10%) of the purchase price.

Step 2: The member then applies from the cooperative Musharakah Mutanaqisah home financing for the balance of 90% of the cost of house amounting RM180,000. The cooperative will approve the application and issue letter of offer for a joint purchase of house with the member from the developer and cooperative to pay the developer the balance of the purchase price.

Step 3: Member and cooperative signs "Musharakah Mutanaqisah joint ownership agreement" which contains the following details: (i) Cooperative will pay the balance of purchase price of RM 180,000; (ii) Member and cooperative agrees to purchase the house based on Musharakah Mutanaqisah.

Step 4: Cooperative will issue an undertaking to the developer to pay the balance (90% or RM180,000) to the developer. Cooperative will pay the developer progressively based on the percentage of completion of the house.

Step 5: On completion of the property, the cooperative will rent the house to the member based on monthly rental e.g. RM1,000. The member will also make payment on the cost of purchasing the house by buying the 90% equity (share) owned by the bank e.g. RM289. Hence, the total monthly installment to be made by member will be RM1,289.

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